No. 93-716

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

OLIN CORPORATION
Petitioner,

v.

FEDERAL TRADE COMMISSION
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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REPLY BRIEF FOR PETITIONER

NEAL R. STOLL
Counsel of Record
JAMES A. KEYTE
ALAN J. MEESE
Skadden, Arps, Slate,
Meagher & Flom
919 Third Avenue
New York, New York 10022
(212) 735-3000
Counsel for Petitioner

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REPLY BRIEF FOR PETITIONER

Respondent's brief reconfirms at least two reasons why the Court should grant Olin Corporation's ("Olin") petition for certiorari.

First, in today's environment of rapidly changing technologies and inevitable consolidations, the antitrust laws must keep pace. This includes recognizing that under *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974), the historical market share of a technologically disadvantaged firm will often overstate that firm's future ability to compete. In arguing that *General Dynamics* has no relevance in the instant case, however, Respondent, as did the Ninth Circuit panel, essentially equates the *General Dynamics* doctrine with the so-called "failing firm" defense. Thus, both Respondent and the panel would require a Section 7 defendant to bear the unqualified burden of proving that its particular technological disadvantage makes it

completely unable to compete in the future. (Res. 4; Pet. App. 25a-26a) Because technological deficiencies are likely to drive mergers and consolidations in the future, it is particularly important for the Court to reconfirm that under Section 7, a plaintiff, including the government, bears the ultimate burden of proving that the historical market share of a technologically disadvantaged firm accurately and fully reflects that firm's future ability to compete.

Second, this Court needs to reconcile the conflicting product market standards set forth in *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962). Under *Brown Shoe*, products should not be placed in the same market if there is not a significant degree of cross-elasticity of demand between them. (Pet. 17-18) At the same time, however, *Brown Shoe* leaves room for placing products in the same market if they appear to be "reasonably interchangeable" in that they serve the same end use and are accepted by consumers. (Res. 5)

The confusion caused by *Brown Shoe* is particularly acute when analyzing highly differentiated products with the same end use, such as a pool sanitizers. Thus, Respondent does not contest that, under *Brown Shoe*, the undisputed lack of a high cross-elasticity of demand between isos and cal hypo would normally place the two products in separate markets. At the same time, however, Respondent argues that, under *Brown Shoe*, isos and cal hypo should be in the same market because they serve the same functional end use and are accepted by consumers. (Res. 5) With good reason, the FTC does not want the Court to resolve the tension within the *Brown Shoe* product market standard: if a lack of cross-elasticity of demand is controlling, there can be no "dry sanitizers" market and isos and cal hypo would each constitute their own markets; if, however, functional interchangeability and consumer acceptance are controlling, the relevant market would have to include liquid bleach, the most basic and historically popular of all pool sanitizers.

In sum, this is a particularly important time for the Court to clarify both the *General Dynamics* doctrine and the *Brown Shoe* product market standard, and this is a particularly good case in which to do so.

I. THE COURT NEEDS TO ESTABLISH THAT THE *GENERAL DYNAMICS* DOCTRINE IS NOT A "FAILING FIRM" DEFENSE

Respondent argues that this case raises no broad principle of law under *General Dynamics*, does not conflict with lower court decisions and raises no issue worthy of the Court's review. (Res. 8) To the contrary, Respondent's brief itself highlights at least three reasons why the Court should review the *General Dynamics* doctrine, each of which stems from the Ninth Circuit panel's erroneous view that *General Dynamics* is a "defense" rather than an essential part of a plaintiff's *prima facie* case under Section 7 of the Clayton Act, 15 U.S.C. § 18.

A. The Court Should Reconfirm That, Under *General Dynamics*, A Section 7 Plaintiff Bears The Ultimate Burden Of Proof

Throughout this case, the FTC has maintained that Olin's viability argument is, in essence, a weakened or failing company "defense" for which Olin had the burden of proving that it would be completely unable to compete in the future. (Res. 4; *see* Pet. 10 n.6) The Ninth Circuit panel avoided the issue, finding that even if the Commission had applied the incorrect standard, the FTC had at least "responded to [Olin's] rebuttal." (Pet. App. 25a) Respondent, as well, argues that since Olin had the burden to rebut the government's *prima facie* case, it was enough that the FTC "pointed to evidence indicating why petitioner's viability argument should fail." (Res. 8 n.7) Left undisturbed, the panel's decision would establish that, under *General Dynamics*, a defendant has the ultimate burden of persuasion to rebut plaintiff's market share evidence once plaintiff

merely responds in any manner or degree to defendant's rebuttal.

The panel's decision is, therefore, in direct conflict with *United States v. Baker Hughes Inc.*, 908 F.2d 981, 991 (D.D.C. 1990), and numerous other decisions recognizing that the defendant's burden under Section 7 is one only of coming forward with rebuttal evidence.[1] The critical point in *Baker Hughes* was not only that the government cannot rest in the face of rebuttal evidence, but that in a Section 7 case the plaintiff *always retains "the ultimate burden of persuasion." Id.* (emphasis added).

The consequences of not placing the ultimate burden of proof on the Section 7 plaintiff are not theoretical. In this case, Olin offered concrete rebuttal evidence of its long-run cost disadvantage, which was never addressed by the FTC.[2] Left unresolved, the conflict between the panel's decision and *Baker Hughes* and other decisions would turn the *General Dynamics* doctrine into the failing company defense for which a defendant has the ultimate burden of proving its future inability to compete. It would also mean that every company that decides to merge with another company because of a technological weakness would have to prove

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1 *See Fruehauf Corp. v. FTC*, 603 F.2d 345, 354 (2d Cir. 1979); *State of California v. American Stores Co.*, 872 F.2d 837, 842 (9th Cir. 1989), *rev'd on other grounds*, 495 U.S. 271 (1990).

2 Olin presented uncontroverted evidence that Nissan's internal cyanuric acid ("CA") costs were significantly less than the average price paid by Olin (about 28¢ for Nissan compared to 55¢ for Olin). (Rx-263A, *in camera*, attached hereto as Appendix A) Once this showing was made, it should have been the government's burden to persuade the trier of fact that Olin was not at a long-term competitive disadvantage. Further, once the ALJ found that the fluctuations in the yen/dollar exchange rate had caused foreign isos prices to rise (Pet. App. 70a), it should have found that CA prices from Nissan to Olin would also have risen. The government, however, was never required to address these points because it was never given the ultimate burden of proving that Olin would be a fully viable isos producer in the long run.

why a Section 7 plaintiff's *prima facie* case is wrong rather than the plaintiff proving why it is correct.

B. The Inability To Make A Critical Input Should Be Within The Scope Of *General Dynamics*

Respondent, and the panel, also treat *General Dynamics* as a failing firm defense by requiring a technologically disadvantaged firm to demonstrate failure in the marketplace before it may invoke *General Dynamics*. Such a limitation of *General Dynamics* is not only inconsistent with the Commission's own Merger Guidelines and the case law, it is a particularly myopic Section 7 principle in today's rapidly changing technological environment.

The *General Dynamics* doctrine, like Section 7 itself, attempts to make a prediction about a firm's likely competitive viability based on its status at the time of the challenged transaction. For this reason, *General Dynamics* does not require that a firm already suffer in the marketplace from its competitive disadvantage before the doctrine will apply.

Indeed, with respect to the inability to make a product, the Commission's own Merger Guidelines state:

> [I]f a new technology *that is important to long-term competitive viability* is available to other firms in the market, but is not available to a particular firm, the Agency may conclude that the historical market share of that firm overstates its future competitive significance.

Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (Apr. 1992), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104 ("*Merger Guidelines*") § 1.521 (Apr. 2, 1992). Significantly, the *Merger Guidelines* do not require that the firm with the technological disadvantage be on the verge of failure in the marketplace, a test the *Guidelines* correctly reserve for the failing firm de-

fense. *Id.* at § 5.1. Until the panel's decision, the case law was in accord. *See, e.g., United States v. Consolidated Foods Corp.*, 455 F. Supp. 108, 137-39 (E.D. Pa. 1978) (defendant's inability to solve technological problems in making pie crust left it with a long-term competitive disadvantage against integrated producers).[3]

Moreover, there is simply no principled basis on which to exclude from application of the *General Dynamics* doctrine those firms that are at a long-term cost disadvantage because of an inability to make a critical input.[4] Indeed, the Commission itself found that "*a manufacturing cost disadvantage may weaken a competitor*" (Pet. App. 57a) (emphasis added), a proposition well established in both law, *see In re B.F. Goodrich Co.*, 110 F.T.C. 207, 321 n.174 (1988), and economics, *see* Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs To Achieve Power Over Price*, 96 Yale L.J. 209, 285 (1986) ("*Raising Rivals' Costs*") ("[i]n determining whether . . . two-tier entry is necessary, the guidelines consider whether the integrated firms *might* engage in 'supply squeezes' against unintegrated rivals.") (emphasis added) (citation omitted).[5] In sharp conflict with these

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[3] The panel attempted to limit *Consolidated Foods* to circumstances in which the technological failure affected product quality rather than competitive viability in any form. (Pet. App. 28a) The FTC does not endorse this distinction, presumably because it directly conflicts with its own *Merger Guidelines*.

[4] It is undisputed that CA represented 50 percent of the cost of isos, was the only input that distinguished isos from other pool sanitizers and, unlike less important inputs, was unavailable on the open market. (Pet. App. 2a) It is disingenuous, therefore, for Respondent to refer to CA as just one of many inputs for the production of isos. (Res. 2)

[5] It remains uncontroverted that there was no competitively structured merchant market for CA and that Nissan did, and would continue to, supply CA to Olin at a premium – if it chose to deal with Olin in the future at all. Respondent's suggestion that Olin had alternative sources of supply for CA (Res. 8) is simply wrong and was not the basis of the *panel's* finding. (*See* Pet. App. 26a-28a)

established principles, the panel would require a firm that is unable to make a critical input to attempt to buy it from a competitor rather than seek to merge with a company that can make that input. As a matter of "market reality," this will not only inevitably lead to higher costs for non-integrated firms, it will also lead to higher prices for ultimate consumers. *See Raising Rivals' Costs, supra*, at 236.

C. Section 7 Remedies Must Be Consistent With The Theory of Liability

Finally, treating *General Dynamics* as a failing firm defense enabled the panel to ignore the inconsistency between the Commission's order to divest the CA plant and the finding that Olin can be a *fully* viable isos producer without a CA plant. Thus, Respondent argues that the "Commission's desire to 'ensure' the success of the divestiture does not indicate that *a captive CA supply is indispensable to viability.*" (Res. 18) (emphasis added)

Only if the *General Dynamics* doctrine is equated with the failing firm defense, however, can this be true. The *General Dynamics* inquiry is not whether a given technology is "indispensable to viability"—i.e., a firm would fail without it—but whether the technology is "important to long-term competitive viability." *Merger Guidelines*, § 1.521. The Commission's and the panel's acknowledgement that a captive CA plan is necessary to "ensure the viability of the divested entity" at a minimum means that a CA plant is important to the long-term competitive viability of isos producers. This, no doubt, is why every isos producer is vertically integrated. *See In re B.F. Goodrich Co.*, 110 F.T.C. 207, 321 n.174 (where a non-integrated firm is at a cost disadvantage, "[it will] not be able to compete with integrated producers"). This factor was never taken into account by the panel or the Commission in the context of *General Dynamics*. In these circumstances, any order requiring Olin to divest its CA plant (rather than license CA technology or supply CA to the divested entity) is clearly

punitive and does not make the isos marketplace any more competitive than it is now.

II. THE COURT NEEDS TO CLARIFY ITS *BROWN SHOE* PRODUCT MARKET STANDARD

This case squarely raises the issue of whether the thirty-two year old *Brown Shoe* product market standard needs to be revisited in light of the enormous confusion it is causing in all antitrust analysis, especially in defining alleged markets that include highly differentiated products with the same end-use.

The problem lies in the menu of *Brown Shoe* "tests" that parties may choose from in defining the relevant market. Thus, under *Brown Shoe*, a relevant product market can be defined using the "cross-elasticity of demand" test, the "reasonable interchangeability of use" test or any one a of a laundry list of "practical indicia."[6] Interestingly, in this case the Commission used all three tests to support its market definition findings: the five percent version of the cross-elasticity test was used to support an isos only market (Pet. App. 44a); the reasonable interchangeability test was used to support the "dry sanitizers" market (Pet. App. 40a-41a); and both the practical indicia and five percent tests were used to support the exclusion of liquid bleach from the market (Pet. App. 50a-52a).

The Court, therefore, needs to clarify whether "reasonable interchangeability" can only be measured by the degree of cross-elasticity of demand between products. *See United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 394-95 (1956). Indeed, most courts now hold that if two products do not have a high degree of demand cross-elasticity, they cannot be reasonably interchangeable and

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[6] These indicia include: "industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." *Brown Shoe*, 370 U.S. at 325.

must be placed in separate markets. (Pet. 20-21) The Court should also make clear that this economically rigorous product market standard may not be compromised simply because the substantial evidence standard of review is being applied (Pet. 21-22), a point Respondent did not care to address.

While attempting to claim that the Commission actually applied a cross-elasticity of demand standard, Respondent ultimately concedes that the Commission and the panel relied on circumstantial evidence of reasonable interchangeability to sustain the "dry sanitizers" market. (Res. 3) Rather than capitulate, however, Respondent makes the incredible claim that the "reasonable interchangeability of use" test *stands by itself* as a distinct standard under *Brown Shoe*, even in the face of a lack of meaningful cross-elasticity between two products. (Res. 3) It argues, therefore, that the panel was correct in upholding the Commission's finding that "isos and cal hypo were reasonably interchangeable *in terms of function and consumer acceptance*." (Res. 5) (emphasis added) The Commission, as well, alluded to a similar flexibility where products were differentiated along a "continuum" of "consumer preferences." (Pet. App. 44 n.9)

Without pause, however, both the Commission and the panel reverted back to other *Brown Shoe* tests in order to exclude liquid bleach from the relevant market. Liquid bleach was thus excluded from the market based on some of the so-called *Brown Shoe* "indicia" (*see* Pet. App. 22a) and on a "low degree of substitution between dry and liquid sanitizers." (*Id.*) Of course, if the panel had applied the same principles to the "dry sanitizers" market, cal hypo and isos could not have been placed in the same market.

In deciding whether *Brown Shoe* needs revisiting, the panel's decision is the best evidence that the multiple *Brown Shoe* standards are particularly prone to conflict in markets involving highly differentiated products. This is because, by definition, the demand for a differentiated product will tend to be less sensitive to the price changes of other func-

tional substitutes. *See Eastman Kodak Co. v. Image Technical Services, Inc.*, 112 S. Ct. 2072, 2085-86 (1992) (based on a lack of cross-elasticity, aftermarkets for Kodak parts and service could constitute economically significant markets). Thus, whether using a five percent test or something close to it, a rigorous economic view of product market definition will tend to place such products in separate markets.

Until the Court clarifies the *Brown Shoe* standard in the context of differentiated products, antitrust plaintiffs, like the government in this case, will be permitted to pick whatever test serves its objectives. *See Brown Shoe*, 370 U.S. at 367-68 and n.3 (Harlan, J., concurring) ("If the Government were permitted to choose its 'line of commerce' it could presumably draw the market narrowly in a case that turns on the existence vel non of monopoly power. . . ."). Indeed, in this case, it was clear that the panel used a simple reasonable interchangeability and consumer acceptance test to include cal hypo in a market with isos, but then reverted back to a cross-elasticity test and the *Brown Shoe* "indicia" to exclude liquid bleach from the market. However, if any one of the *Brown Shoe* tests were applied to all potential pool sanitizer substitutes, the dry sanitizer market would simply dissolve.

It is therefore submitted that the petition for a writ of certiorari should be granted.

Respectfully submitted,

/s/ Neal R. Stoll

Neal R. Stoll
Counsel of Record
James A. Keyte
Alan J. Meese

Skadden, Arps, Slate,
Meagher & Flom
919 Third Avenue
New York, New York 10022
(212) 735-3000

Counsel For Petitioner

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